(3)

No. 88-36



IN THE

# Supreme Court of the United States

OCTOBER TERM, 1988

BENEFICIAL CORPORATION, FINN M.W. CASPERSEN, ANDREW C. HALVORSEN,

*Petitioners,*

—against—

ROBERT M. DEUTSCHMAN,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## PETITIONERS' REPLY BRIEF

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# PETITIONERS' REPLY BRIEF

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Petitioners respectfully submit this short reply to the Brief of Respondent in Opposition to Petition for a Writ of Certiorari ("Resp. Br."). Respondent makes only a few points in opposition to the petition which merit a response.

## I

## THE DECISION OF THE COURT OF APPEALS CONFLICTS WITH A DECISION OF THE EIGHTH CIRCUIT

In *Laventhall v. General Dynamics Corp.*, 704 F.2d 407 (8th Cir.), *cert. denied*, 464 U.S. 846 (1983), General Dynamics failed to disclose an impending dividend while purchasing shares of its common stock in the open market. At the same time, Laventhall sold call options and failed to receive the higher price for these options he would have realized had General Dynamics disclosed its dividend plans. The Eighth Circuit dismissed Laventhall's complaint.

Respondent tries to distinguish *Laventhall* by arguing incorrectly that it was decided only on the basis of a lack of causation or injury, whereas here "the causation element of a Rule 10b-5 cause of action is met." Resp. Br. at 18-19. But the Eighth Circuit did not hold that Laventhall was uninjured by General Dynamics. It held that Laventhall lacked standing by reason of his status as an option trader, quoting from Judge Lasker's opinion in *O'Connor & Assoc's v. Dean Witter Reynolds, Inc.*, 529 F. Supp. 1179, 1184 (S.D.N.Y. 1981), that "[t]he relationship between corporate insiders and shareholders stands in stark contrast to the lack of relationship between corporate insiders and options traders." 704 F.2d at 411.

Respondent's attempts to distinguish among an insider trading case, a nondisclosure case and an affirmative misrepresentation case involving a corporate spokes-

man avail him nothing. Resp. Br. at 13-14 and n.9. The only important difference among these cases that Respondent can point to is the difference in circumstances giving rise to the duty to disclose, *e.g.*, the disclose-or-abstain rule in insider trading cases and the "ever-present duty not to mislead" in affirmative misrepresentation cases. *Basic Inc. v. Levinson*, ___ U.S. ___, 108 S. Ct. 978, 988 n.18, 99 L. Ed. 2d 194, 214 n.18 (1988). Resp. Br. at 13-15. But while the duty to speak truthfully can arise from a number of different circumstances, that does nothing to answer the question at the heart of the conflict between *Laventhall* and this case, which is, *once the duty to make truthful disclosure arises, to whom is that duty owed*?

Nothing in Rule 10b-5 nor Section 10(b) distinguishes among those to whom a duty of disclosure is owed based on whether the person with the duty to speak truthfully is an insider trader or a corporate spokesman, or on whether the breach of the duty is occasioned by silence or by speech. Unless such a distinction exists, and neither the Respondent nor the Third Circuit has said why it should, there is a direct conflict between *Laventhall*, holding that an options trader was not owed a duty by a corporation engaged in insider trading, and the opinion below, holding that an options trader was owed a duty by a corporation making a corporate announcement.

It is not surprising, therefore, that the district courts[1] and commentators[2] considering this issue have concluded that the *Laventhall* rationale conflicts with that used by the Third Circuit.

## II

## RESPONDENT'S OTHER POINTS ARE WITHOUT MERIT

Respondent makes several references to the fact that issue has not been joined and that no proceedings have been held as to class certification, arguing that the question presented by this petition is premature. Resp. Br. at 2, 5 & n.3. His position, of course, is wholly incorrect. A

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1 See *Bianco v. Texas Instruments, Inc.*, 627 F. Supp. 154, 161 (N.D. Ill. 1985) ("We do not agree that the distinction between affirmative misrepresentation and nondisclosure calls for a different rule as to the standing of options traders to sue under § 10(b)."). In *in re Warner Communications Sec. Litig.*, 618 F. Supp. 735, 743 (S.D.N.Y. 1985), *aff'd*, 798 F.2d 35 (2d Cir. 1986), Judge Keenan observed, before the decision below was rendered, that the courts are "split" and that *Laventhall* conflicts with *In re Digital Equip. Corp. Sec. Litig.*, 601 F. Supp. 311 (D. Mass. 1984) ("*Digital*") and *Backman v. Polaroid Corp.*, 540 F. Supp. 667 (D. Mass 1982) ("*Backman*"), both of which reached identical results to that below on similar facts.

2 *E.g.*, Note, *Private Causes of Action for Option Investors Under SEC Rule 10b-5: A Policy, Doctrinal and Economic Analysis*, 100 Harv. L. Rev. 1959, 1960 and n.10 (1987) ("Courts have split, however, as to the standing of option holders to bring private actions against insiders for Rule 10b-5 violations.") (citing *Laventhall*, *Digital*, *Backman*, and similar cases).

plaintiff's standing is a threshold issue which may properly be resolved by this Court on a motion to dismiss prior to an answer to the complaint or any other proceedings. *See Warth v. Selden*, 422 U.S. 490, 498 (1975); *LaDuke v. Nelson*, 762 F.2d 1318, 1325 (9th Cir. 1985) ("Standing . . . is a jurisdictional element which must be satisfied prior to class certification."), *modified on other grounds*, 796 F.2d 309 (9th Cir. 1986); *see also Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979) (limits of implied cause of action under Investment Advisers Act of 1940 tested on motion to dismiss); *Manor Drug Stores v. Blue Chip Stamps*, 339 F. Supp. 35 (C.D. Cal. 1971), *rev'd*, 492 F.2d 136 (9th Cir. 1973), *rev'd*, 421 U.S. 723 (1975).

Next, Respondent states that the "policy considerations advanced by the Petitioners are not for the courts to weigh." Resp. Br. at 24. Respondent is wrong again. Private rights of action under Section 10(b) and Rule 10b-5 are not creatures of statute but of judicial implication. Thus, as this Court stated in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), when interpreting the scope of the private right of action under Rule 10b-5, it is "proper that we consider . . . what may be described as policy considerations." *Id.* at 737; *see also Cannon v. University of Chicago*, 441 U.S. 677, 689, 709-712 (1979).

Finally, plaintiff attempts to counter the strong policy argument, accepted by many courts[3], that option trad-

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3 *E.g., Laventhall v. General Dynamics Corp.*, 704 F.2d 407, 411 (8th Cir.), *cert. denied*, 464 U.S. 846 (1983); *Data Controls North, Inc. v. Financial Corp. of America, Inc.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,958, at 90,446-90,447 (D. Md. May 23, 1988); *Starkman v. Warner Commu-*

(Footnote continued)

ers should be denied standing to sue the corporation because they contribute nothing to the corporation, by pointing out that the "logical conclusion" of such an argument is to deny standing to sue to purchasers of a corporation's securities on the open market because the consideration paid likewise does not inure to the corporation. To the contrary, such an argument is not only illogical, it is frivolous, as the existence of a secondary market for a corporation's securities provides a direct benefit to the corporation by enhancing its ability to successfully sell its securities to the public in the first place. Reilly, *Secondary Markets* in *Handbook of Financial Markets: Securities, Options, Futures* 135, 138 (F. Fabozzi & F. Zarb eds. 1981).

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(Footnote 3 continued from previous page)
*nications, Inc.*, 671 F. Supp. 297, 304-05 (S.D.N.Y. 1987); *In re McDonnell Douglas Corp. Sec. Litig.*, 567 F. Supp 126, 127 (E.D. Mo. 1983).

## CONCLUSION

For the foregoing reasons, and for the reasons set forth in the petition, Petitioners respectfully submit that the petition for a writ of certiorari should be granted and the case set for oral argument.

Respectfully Submitted,

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